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SUBJECT: U/S TAYLOR'S DISCUSSIONS WITH GOT ON ECONOMIC  
REFORM AND ECONOMIC OUTLOOK, DECEMBER 27-28

Sensitive but unclassified, and not for internet distribution.

[11.](#) (SBU) Summary: In his talks in Ankara December 28 and 29, Treasury Under Secretary Taylor several times stressed the need for the GOT to implement economic reform, specifying the 2003 primary budget surplus, resolution of two large banks, and implementation of the Public Procurement Law as three key issues. In response, Deputy Prime Minister Sener, State Minister in charge of Treasury Babacan and Finance Minister Unakitan separately confirmed that the GOT was committed to continuing the existing IMF-backed economic reform program. However, implementation of the program is stalled, and there are no indications that the GOT is preparing necessary actions to implement key program conditions. U/S Taylor's interlocutors did not commit to the 6.5 percent of GNP primary budget surplus target for 2003. Babacan said the Public Procurement Law would be implemented on time in January, but that the GOT would also seek to amend the law. Taylor also discussed the general economic outlook with GOT officials. Year-end 2002 growth forecasts now range between 6.5 - 6.8 percent; the GOT and Central Bank have agreed on 2003 targets of 20 percent CPI increase and 5 percent GNP growth. End Summary.

#### Concern with Policy Slippage

[12.](#) (SBU) Treasury Under Secretary Taylor, during his December 27-28 meetings in Ankara with Deputy Prime Minister Sener, State Minister Babacan and Finance Minister Unakitan, raised the importance of Turkey's economic reform program. Fully implementing this IMF-backed program is a key element to maintaining market confidence. Taylor stressed these areas of concern over possible slippage:

-- Fiscal policy, especially the 6.5 percent of GNP primary surplus, which Taylor noted is part of the government's agreement with the IMF for 2003;

-- Banking sector reform, and in particular the banking board's resolution of two undercapitalized banks (Pamuk and Yapi Kredi); and

-- The Public Procurement Law, passed in January 2002 and scheduled to come into force in January 2003. This law will establish more transparent rules for, and allow foreign participation in, bidding on government tenders.

[13.](#) (SBU) Babacan, Unakitan and Sener, in separate meetings, said the new government was committed to continuing the existing IMF program. Babacan said the government agreed in principle with the economic reform strategy of both the IMF and World Bank, though there were disagreements over details with both agencies.

[14.](#) (SBU) On fiscal policy, Babacan blamed the prior GOT government for over-spending and creating a primary surplus shortfall for 2002. Treasury U/S Oztrak added that, while the markets were expecting a 2002 primary surplus of 5 to 5.5 percent of GNP, his latest estimates were that it would be less - perhaps 4.5 percent of GNP. Asked about the GOT's commitment to the 6.5 primary surplus target for 2003, Babacan said "we'll try." He added that the 2003 budget would increase social expenditures, given that 20 percent of the population was below the official poverty line, but he didn't specify expenditure cuts in other areas to pay for these increases. U/S Taylor noted the GOT's less than full commitment to the 6.5 percent surplus, and said a full commitment was needed.

15. (SBU) Treasury U/S Oztrak said the GOT would generate savings in 2003 through reforming health care expenditures. Finance Minister Unakitan further specified that cuts would come from deferral of non-urgent investment projects, reducing the fleet of state-owned vehicles, controlling pharmaceutical costs, and a performance-based program for overall government downsizing.

16. (SBU) On structural reforms in the banking sector, Babacan stressed that the GOT was committed to independence of the banking board (BRSA) and "has empowered this agency to do its job." Of course, he continued, there is a need to improve the BRSA's operations, but any changes made would be in the direction of increasing the agency's transparency and its reporting to the public. He added that that the resolution of two banks was in the courts system, the GOT could not interfere. On the Public Procurement Law, Babacan said there were "some problems in implementation." Unakitan said bureaucrats were claiming that the law might interfere with basic government operations. But the GOT had decided to implement it on time in January 2003, and at the same time to seek several "technical amendments to correct the law's flaws." (Comment: World Bank contacts tell us the 16 amendments proposed by the GOT, if passed by parliament, would in effect gut the law by excluding procurement by municipalities and state economic enterprises. End Comment.)

17. (SBU) Babacan described two economic policy initiatives of the new government - in privatization and foreign direct investment (FDI). He stressed that no government in Turkey had ever had such strong political support for privatization: the GOT was committed to accelerating privatization and would release its 2003 program in January to implement this vision.

Furthermore, the new GOT sees FDI as crucial. The GOT would soon submit five separate laws to parliament aimed at encouraging FDI; it has also established an inter-agency coordinating committee to enhance the investment climate, staffed at the undersecretary (i.e., agency head) level, which includes private sector representatives and which Babacan will chair.

18. (SBU) Taylor welcomed this focus on privatization and FDI, in addition to the other IMF program conditions. He stressed, however, that markets will focus on the budget and on the banking sector issues as well as FDI. He warned that the 2002 primary budget shortfall will require a IMF board waiver, and he noted that the IMF board will question what the GOT has done to reduce this shortfall.

#### Economic Outlook for Year-End 2002 and 2003

19. (SBU) Taylor also discussed Turkey's economy with State Minister Babacan, Central Bank Governor Serdengeçti, Treasury U/S Oztrak, and State Planning Undersecretary Tiktik over lunch December 28. Taylor began by asking Governor Serdengeçti his view of the recent declines in Turkish financial markets.

110. (SBU) Serdengeçti said there were two main reasons: first, conflicting statements from various politicians had caused worries in the markets over the GOT's commitment to economic reform; and second, talk of an imminent war in Iraq had added to the volatility.

111. (SBU) On prospects for growth, SPO head Tiktik said his agency estimates year-end 2002 growth will be 6.8 percent, while Treasury U/S Oztrak puts the figure at 6.5 percent. Central Bank Governor Serdengeçti commented that this strong performance shows the Turkish economy's resilience - this sort of rebound also happened after the 1994 crisis. The rebound this time has been broad-based: agricultural production helped, but so did tourism and industry. Exporters showed their adaptability in the face of slow growth in Europe which is the main export market. But, Serdengeçti continued, Turkey needs stable, sustainable growth. By the third quarter of 2003, Turkey reached the industrial production levels of 1997 and 2000 - the two peaks of the past decade. Further growth will only come from productivity gains through private sector investment, he concluded.

112. (SBU) Serdengeçti and Oztrak affirmed that the GOT and Central Bank had agreed on several key macro-economic targets for 2003: the 20 percent CPI increase, and the 5 percent GNP growth target.

13. (SBU) Treasury has cleared this message.  
PEARSON